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August 14, 2008

Mr. Doug Dunham
Deputy Assistant Director
Arizona Department of Water Resources
3550 N. Central Avenue
Phoenix, Arizona 85012

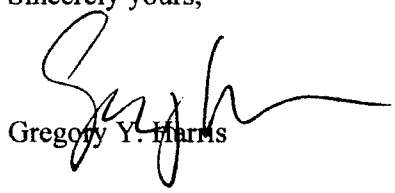
Re: Draft Transportation Rules: Transportation of Groundwater to an Active Management Area - Proposed Rules R12-15-1401 through R12-15-1411

Dear Mr. Dunham:

On behalf of Chino Grande LLC, we have attached a copy of the comment letter prepared on my client's behalf with respect to the above-referenced draft groundwater transportation rules. We appreciate your consideration of these comments.

After you have had an opportunity to review this submission, if we can provide you with additional information or further explanation, please let us know.

Sincerely yours,



Gregory Y. Harris

GYH/cre

cc: Kenneth Slowinski (by e-mail with attachment)
David Green (by e-mail with attachment)
Michael McNulty (by e-mail with attachment)

Comments Concerning the Rules Proposed by the
Arizona Department of Water Resources:
ART. 14. **"Transportation of Groundwater to an Active Management Area"**
Proposed Rules R12-15-1401 through R12-15-1411

Submitted by Gregory Y. Harris and Michael F. McNulty
Of Lewis and Roca, L.L.P.
On behalf of Chino Grande, LLC
August 15, 2008

On March 4, 2008, the Governor's Regulatory Review Council sustained an appeal lodged by the Salt River Project, causing DWR to move forward with SRP's petition to initiate rulemaking regarding the "Identification of Historically Irrigated Acres in the Big Chino Sub Basin." Given the numerous issues arising out of the interpretation of Article 8.1 of Chapter 2, Title 45, A.R.S., DWR consolidated its proposed rulemaking for the Big Chino Sub Basin to include procedures for transporting groundwater from all of the basins identified in Article 8.1 of the statutes.

The Department's efforts to solicit public input have been exemplary. In what can only be called an obscure corner of the Arizona water law arena, DWR has been able to identify score of parties that might be affected, and have communicated their intentions, and the Department's numerous draft proposals to anyone who showed the least interest. Chino Grande, L.L.C. ("Chino Grande") is one such affected party, and is the owner of substantial acreage in Yavapai County in the Big Chino Sub Basin, including lands with historically irrigated acreage. Chino Grande owns farmland, including farmland that the Department has previously determined to have been irrigated in the applicable 1975-1990 timeframe as provided in A.R.S. §45-555 (D)(3). Because of its ownership of this farmland, Chino Grande is vitally interested in the proposed rules. It has monitored numerous informal briefings over the last four months that were hosted by DWR, and now wishes to supplement the informal comments it has provided to the Department concerning the proposed rulemaking by providing the following formal comments.

From Chino Grande's perspective, the *raison d'être* for A.R.S. §§45-552 through 45-555 is to facilitate the importation of groundwater into Arizona's active management areas, while providing for regulation and control of transportation in order to prevent "double pumping" in the form of contemporaneous transportation of water and the use of water for irrigation purposes. Consequently, any provision in the proposed rules that frustrates that goal is contrary to the spirit and the letter of the law. As discussed below, we believe that the Agency may achieve its goals in a way that allows for appropriate policing of transportation of groundwater pumped from historically irrigated acreage without creating the risk that valuable water rights associated with

that land would "disappear" and be forfeited and lost[1] simply due to the filing of an application to transport that water under A.R.S. § 45-555.

- **Pumping "from the land" analysis.**

For several years, the Department has evidenced its understanding that A.R.S. 45-555 allows cities or towns that own or lease HIA lands in the Big Chino Sub-Basin to withdraw groundwater from these lands and to transport the water into the Prescott AMA in amounts calculated by multiplying 3 a.f./acre times the total number of HIA lands that it owns or leases. DWR has said that the transportation allotment must be withdrawn from a well located upon the HIA lands that the city or town owns, but the Department has not construed the statute to mean that the city or town must own and operate as many wells as it owns parcels of historically irrigated acreage.

The Salt River Project, to the contrary, insists that the words in the statute must be read to require the drilling and operation of as many wells as there are parcels. At the same time, the position advocated by the SRP has the potential of forcing some groundwater withdrawals into the Williamson Valley, which is an area for which it has shown greater concern. Were the Prescott AMA municipalities able to exercise water rights derived from HIA in the Williamson Valley by pumping wells located in the Chino Valley, that would seem to be in the Project's best interests. Chino Grande believes that those municipalities are likely to coalesce into a joint-use project with wells and withdrawals located in the center of the Big Chino Sub Basin, far from the Project's most critical areas of concern – but only if the HIA lands in the Williamson Valley can be exercised, as the Legislature intended, from HIA lands elsewhere in the watershed.

As briefly noted above, Chino Grande is the owner of a significantly sized HIA parcel, and would not be greatly impacted if DWR were to agree with SRP's request – which would have the effect of making the statute (and the transportation of water from HIA lands) far more difficult and expensive to implement. And yet, we return to our central philosophical principle: the *Raison d'être* for A.R.S. §§45-555 is to facilitate the importation of groundwater into the Prescott active management area.

While numerous, valiant arguments are made about the "plain meaning" of the statute, the sheer number and length of those arguments reveal how difficult it is to parse the Legislative intent of phrases like "from the land." Chino Grande believes that the Legislature drafted the statute to foster and enable growth and development in the Prescott active management area. Consequently, a reading of the statute that would frustrate growth and development of the Prescott active management should be rejected as inconsistent with the Legislature's intent. Those involved or familiar with the dynamics of this issue in 1991 when the Legislature enacted Article 8.1 know that the existence of numerous small irrigated parcels in the Big Chino Sub Basin was a fact of life. This certainly includes the Salt River Project, whose records of water use in watersheds upstream of its dams are second to none.

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[1] Along with the loss of the water rights, the loss of HIA status would have a significant negative impact on the value of Chino Grande's farmland.

SRP's arguments would require huge expenditures by a city or town wishing to move groundwater to the Prescott AMA from a small farm with historically irrigated acreage. The city or town would need to construct or renovate a production well and construct a transmission line to move small quantities of groundwater for such distance as lay between that farm and the transmission main that will transport groundwater ten or twenty or thirty miles to the place of use. For farms of ten acres, or five, or two (that will have allowances of between 6 and 30 acre feet/year), the economic logic of participating in this legislatively-created program would be lost. This reading would effectively lead to the forfeiture of every small farmer's right under the statute to sell his or her land to municipalities in the Prescott AMA, and would simply emasculate the process identified by the Arizona Legislature.

Indeed, such a reading would mean that the number of parcels that can be economically used to serve as well fields for those cities and towns, would be extremely small – perhaps fewer than five. Given the breadth of participation in this effort in 1991, the Legislature could not have intended such a sparing distribution of benefits to landowners, nor such a diminution in the targets of opportunity for the cities and towns in the Prescott active management area.

- **The 'permanent' retirement of farmland is not a requirement of the statute.**

The first obstacle to groundwater transportation that we wish to discuss is proposed R12-15-1405.B.4.b. In this proposed rule, the Department expects owners of lands seeking to transport groundwater to the Prescott AMA to provide "(iv) A copy of a document recorded with the county recorder imposing a restrictive covenant on the land prohibiting the irrigation of the HIA with any water at any time in the future." We do not believe that the Legislature made or authorized this requirement as a component of Article 8.1 in general or A.R.S. § 45-555 in particular. Moreover, we do not believe that the legislature intended that landowners' water rights would be withdrawn, repealed or eliminated and the value of their land diminished by the mere act of filing an application for permission to transfer water *to be reviewed* by DWR. To be sure, Chino Grande understand that DWR wants to prevent the situation from arising in which HIA lands continue to be irrigated at the same time it is pumped, and support this goal, but do not agree with the means that DWR proposes to employ to prevent this result.[2]

As you know, the current groundwater code became part of Arizona law in 1980 with the enactment of Title 45, Chapter 2 of the Arizona statutes. The Legislature enacted provisions of Title 45, article 8, relating to the transportation of groundwater as a part of the 1980 effort to establish a comprehensive code relating to groundwater. More recently, portions of the laws related to the transportation of groundwater enacted in 1980 have been specifically made applicable to withdrawals of groundwater for transportation to an active management area

[2] It may even be argued that the SRP proposal that would prevent the aggregation of well activity for pumping and transportation purposes makes the job of policing difficult. Allowing wells to be "consolidated" would ease compliance inspections by DWR as it monitors transportation applications that it has approved.

enacted as Article 8.1 of Title 45 in 1991.[3] Notably, Article 8.1 contains a general statute applicable to limitations on transportation to active management areas. A.R.S. § 45-551.[4] This article also contains provisions which pertain to the transportation of groundwater from specific basins within the state to active management areas as follows:

Section 45-552	McMullen Valley basin
Section 45-553	Butler Valley Basin
Section 45-554	Harquahala irrigation non-expansion area ("INA")
Section 45-555	Big Chino Sub-basin

Each of these statutes uses a separate approach and formulation for the variables to be considered by the director of the DWR with respect to water transfers within the particular basins or INA. As previously noted, each of these sections is subject to the damages provision contained in section 45-545. This statute identifies the factors to be considered in determining whether damages lie for transportation of water may be imposed. Subsection B specifically provides that in determining whether there has been injury and the extent of any injury, the court shall consider all acts of the person transporting groundwater toward the mitigation of injury including: (1) retirement of land from irrigation; and (2) discontinuance of other pre-existing uses of groundwater.

It would seem that the policy underlying this damages provision that applies to all the withdrawal provisions contained in Article 8.1 concerns the requirement that if permission is to be granted to permit water to be transported from land, that use may be conditioned upon the agreement that the previous use of water from that land for irrigation purposes would cease before transportation began. This is consistent with the policy contained in section 45-401 to "conserve, protect and allocate the use of groundwater resources of the state and to provide a framework for the comprehensive management and regulation of the withdrawal, transportation, use conservation and conveyance of rights to use the groundwater in the state."[5] We note that section 45-552 pertaining to the McMullen Valley basin contains **no** specific reference to the retirement of water from use as a condition of granting an application to transport water. Yet, in the June 18 draft, the Department provided that for transportation to be permitted in the McMullen, Harquahala and Big Chino, the land that had been previously irrigated must be withdrawn (or retired) from use in all of the basins covered by Article 8.1. Proposed Rule A.A.C. R12-15-1410 provides as follows:

> **A.** HIA Land in the Big Chino sub-basin shall not be irrigated with any water at any time after the land has been retired from irrigation pursuant to R12-15-1405(B)(4)(b).

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[3] See A.R.S. § 45-551(C) (making the damages provision established in section 45-545 applicable to Article 8.1 as part of the enactment of Laws 1991, Ch. 212).

[4] We have reviewed thoroughly all extant materials related to the legislative history for the enactment of this law, and have found not one page that suggests that the Legislature envisioned, or even discussed, the concept of the "permanent" retirement of farmland.

[5] A.R.S. § 45-401(B).

B. HIA Land in the McMullen Valley basin that is identified in a permit to transport groundwater from the basin issued pursuant to R12-15-1403 shall not be irrigated with any water in a year in which groundwater is withdrawn from the basin for transportation to an initial AMA pursuant to the permit.

C. Eligible irrigation acres in the Harquahala INA that are identified in a permit to transport groundwater from the INA issued pursuant to R12-15-1407 shall not be irrigated with any water in a year in which groundwater is withdrawn from the INA for transportation to an initial AMA pursuant to the permit.

In McMullen Valley and the Harquahala Valley, one rule pertains (a year by year election: transportation or farming); and in the Big Chino Sub Basin, a different rule pertains (to elect transportation, is to abandon agriculture forever). Yet, as we read Article 8.1, no part of the statutes pertaining to McMullen Valley or the Harquahala INA specifically provide that the land "shall not be irrigated with any water in a year in which groundwater is withdrawn from the [basin or INA] for transportation to an initial AMA pursuant to the permit mandate withdrawal" as provided in the draft rule. We believe that DWR's approach is consistent with policy of conserving water, and is appropriate. At the same time, we also believe that nothing in Article 8.1 prevents the formulation shown for McMullen Valley or the Harquahala INA to be made applicable to Big Chino.

Moreover, the Legislature has demonstrated the ability to require "permanent" retirement of farmland when that is the objective that it seeks to implement. For example, A.R.S. §45-452(B) describes lands which a landowner can seek to have retired from irrigation, using these words:

> B. In an initial active management area, a person who owns acres of land which may be irrigated pursuant to subsection A of this section may apply to the director to **permanently** retire all or a portion of such acres from irrigation and to irrigate conjunctively with central Arizona project water the same number of substitute acres.
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> [Also see subsections C and D]

That is, when the Legislature wishes to describe a process in which land is to be retired "permanently", it has said so, in so uncertain terms. Similarly, A.R.S. §§45-437.01, 45-437.02 and 45-437.03[6] all permit the substitution of irrigable acreage, for those who seek to "permanently" retire formerly irrigated farmland.[7]

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[6] § 45-437.01. In an irrigation non-expansion area, a person who owns acres of land which may be irrigated pursuant to section 45-437 may apply to the director during the central Arizona project contracting period, but no later than January 1, 1995, to **permanently** retire all or a portion of such acres from irrigation and to irrigate conjunctively with central Arizona project water the same number of substitute acres.

Finally, we cannot harmonize a legislative authorization to use lands that are leased by a municipality, with regulatory requirement that the lands must be retired from agriculture forever. A lease is not forever. A lease requires that the dominion of the lessee eventually be relinquished, and the land returned to the lessor. In this context, it makes no sense to contemplate a rule that allows land to be leased with the water rights associated with HIA lands to be transported with the idea that at the end of the lease term, the land would be returned to the lessor with the right to farm extinguished

- **The retirement of farmland should not be required until the transportations of groundwater can begin.**

The next issue we wish to address concerns the timing of farmland retirement. The Department proposes a two tier process: – a determination of HIA status – and then a quantification of a transportation allotment. The quantification of a transportation allotment (which follows a determination of which lands have been defined as "HIA" pursuant to R12-15-1405.A. and B., and an approval of legal descriptions) is, candidly, a fairly ministerial process: the only thing left to do is to multiply acres by 3.

However, the Department's proposal morphs or blends the determination of the size of the allotment, into the trigger for permanent, irrevocable retirement. Because the Department expects retirement to be permanent, forcing this election and result at the time of the application for the quantification of the potential transportation allotment is exceedingly **non**-ministerial, punitive and not consistent with the underlying statutory mandate. The relinquishment, in perpetuity, of one's right to irrigate farmland is of great consequence, in terms of the water and the land that had been irrigated with that water. It seems inappropriate to link this irrevocable election to a process that is intended merely to calculate "HIA x 3," particularly in the absence of a statute compelling or authorizing this result.

Practically speaking, the importation of groundwater by cities and towns in the Prescott AMA ("PrAMA municipalities") is driven principally by the need to ensure the availability of an assured water supply (an "AWS") for new subdivisions within their service areas. But the

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§ 45-437.02. A. In an irrigation non-expansion area, a person who owns acres of land which may be irrigated pursuant to section 45-437 may **permanently** retire those acres from irrigation and substitute for those acres the same number of acres in the same irrigation non-expansion area if the owner demonstrates to the director's satisfaction that all of the following apply ...

§ 45-437.03. A. In an irrigation non-expansion area, a person who owns acres of land which are contiguous and which may be irrigated pursuant to section 45-437 may apply to the director to **permanently** retire a portion of those acres from irrigation and substitute for the retired acres the same number of acres.

[7] Also see, § 45-465.01.A. A person who owns acres of land within an initial active management area which were legally irrigated at any time during the five years preceding January 1, 1980 and which have not been retired from irrigation for a non-irrigation use pursuant to section 45-463 or 45-469 may **permanently** retire such acres from irrigation ....

PrAMA municipalities must seek transportation authority first, and then seek DWR's concurrence that the water can be used for an AWS in the PrAMA thereafter.

If the first application is successful, the municipality would be able to move forward to spend the funds needed for infrastructure development (literally millions and millions of dollars) in order to bring that water into the PrAMA. Each municipality in the PrAMA that seeks DWR's approval for transportation and assured water supplies would need to borrow the funds needed to construct the necessary infrastructure. But from a practical perspective, no lender would loan those funds until and unless DWR has approved both the transportation, and the AWS determination. Unfortunately, a finding that water can be transported does not mean that AWS requirements have been met.

However, because the Department's draft rules have been structured to require retirement as a precondition for transportation authority to be granted, landowners will have been forced to "extinguish" their right to irrigate lands in this sub-basin, forever, before the Department determines a municipality's legal ability to use the groundwater for an AWS. If the municipality should fail to obtain that second approval, valuable property rights would have been forfeited without the commensurate benefit of having the water allotment used in the Prescott AMA. This is a somewhat alarming prospect, and one that should be avoided. Moreover, this approach raises many questions associated with the costs (and benefits) of this approach including: 1) what happens with the "retired water rights" if the AWS is denied? 2) If DWR does not act on the AWS application, but instead the municipality withdraws the application, are the water rights still forfeited? 3) Who benefits from an approach that would cause water rights to be forfeited?

Transportation allotment decisions should be flexible enough to allow farming in the interim, and should defer the requirement for the retirement or extinguishment of irrigation rights until the water can actually [legally, physically, and financially] be transported into the PrAMA. No landowner will sell or lease HIA, or will record restrictive deed covenants, until the flow of funds for relinquishment of those rights is a certainty.

On the other side of the same coin, a municipality ought not to be forced into guaranteeing lease payments, or otherwise compensating a landowner for the irrevocable forfeiture of irrigation rights, until the municipality can physically move water into the PrAMA.

The statute does contemplate retirement of irrigation rights, of course[8]. But to require the forfeiture of those property rights before anyone knows if groundwater can actually be transported puts both landowners and PrAMA municipalities into the unenviable decision of buying or selling water rights before anyone knows if they can be put to use in the PrAMA.

What a lender will need to know is this: that upon the extinguishment of the right to irrigate, a PrAMA municipality will have the right to transport groundwater. Consequently, we propose that DWR only require retirement as a condition of transporting water, and <u>not</u> as a condition of quantifying a transportation allotment. We recommend that the Department modify

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[8] As already noted, it is not clear that the Legislature intended this "retirement" to be permanent, as when the Legislature intended permanence, it has said so. See, e.g. A.R.S. § 45-452(B).

the requirement of filing the proof required under R12-15-1405.B.4.b until a municipality is ready to actually move groundwater into the PrAMA. In the alternative, we recommend that the rule be revised to condition the grant of the transportation/AWS applications on the execution of a an agreement to retire the water. The proof of retirement can be staged so that it commences with actual transportation (rather than hypothetical transportation) of groundwater into the PrAMA.

- **Eliminate the requirement of imposing covenants running with the land.**

R12-15-1405 establishes a procedure under which a city or town in the PrAMA can request the computation of the amount of water that can be transported under 45-555 A-D. Part of the proposed procedure, R12-15-1405.B.4.b., requires that the HIA to have been retired from irrigation. The last of the proposed requirements, at (B)(4)(b)(iv), is the necessity of providing the Department with: "A copy of a document recorded with the county recorder imposing a restrictive covenant on the land prohibiting the irrigation of the HIA with any water at any time in the future."

There is no statutory requirement in A.R.S. §45-555 or elsewhere for the execution and recordation of restrictive deed covenants. The Department has processed the conversion of tens (hundreds?) of thousands of acres of irrigated farmlands in the Active Management Areas, without any need for a landowner to burden title to land. If there have been enforcement problems with this lack of deed covenants in the PrAMA's, the Department's position might make sense, but we know of no such problems. Moreover, the transportation may stop, and this approach would cloud the title to the property, perhaps in perpetuity,? As such, we recommend that subsection (iv) of R12-15-1405.B.4.b., be deleted.

- **Any Big Chino Sub Basin landowner should be able to file an applications under R12-15-1404**.

As proposed, R12-15-1404 requires as a precondition of determining whether land is "historically irrigated acreage", that the Department receive an application from a PrAMA municipality. This requirement places an uncomfortable burden upon those landowners who do own lands that were irrigated in the applicable historic period. In order for a landowner to know, one way or another, whether the lands will be deemed by DWR to be eligible for HIA designation, that landowner must already have made some sort of deal with a city or town in the Prescott AMA. But as a practical matter, a deal may not be struck by a city or town until DWR makes the HIA designation.

Nothing in A.R.S. §45-555 or elsewhere suggests that DWR is precluded from making such a determination upon the request of an affected landowner. Thus, the rule should be revised to allow a landowner to obtain a determination from DWR that a land qualifies as HIA lands. Chino Grande believes that the failure to allow for this opportunity would impose significant economic costs on landowners who own lands that would be classified as HIA lands. At the same time, this failure would also grant a windfall to "entities eligible to transport groundwater"

that could leverage their exclusive ability to obtain HIA designations from DWR during the contract negotiation process for water rights with the landowner. As such, we believe that the Department's prohibition on considering such applications unnecessarily tilts the balance of equities all the way towards the cities and towns. Property owners should not be placed in such an awkward and imbalanced position by the rule.

We appreciate this opportunity to share our thoughts on the proposed draft rules.